IN THE

# Supreme Court of the United States

OCTOBER TERM, 1940

No. .....

ARMATURE EXCHANGE INCORPORATED, a corporation, also known as THE ARMATURE EXCHANGE, a corporation, also known as THE ARMATURE EXCHANGE INCORPORATED, a corporation,

*Petitioner,*

*vs.*

UNITED STATES OF AMERICA,

*Respondent.*

## BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI.

### Jurisdiction.

The judgment of the Circuit Court of Appeals was entered January 17, 1941.

The statute under which jurisdiction is invoked is section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925 (28 U. S. C. A. 347).

Petitioner urges that the Circuit Court of Appeals for the Ninth Circuit has decided an important question of Federal law which has not, but should be settled by this

Court, and has decided an important question of general law probably untenable and in conflict with the weight of authority; that this Honorable Court has jurisdiction of the matter by virtue of the above cited statute as interpreted by Rule 38, Subsection 5 (b), Revised Rules of the Supreme Court of the United States now in effect.

## Opinions and Decree Below.

The opinion of the District Court [R. 11] is reported in 28 Fed. Supp. 10. The decree of the District Court was entered and recorded on the 16th day of June, 1939. [R. 25-26.] The opinion of the Circuit Court of Appeals for the Ninth Circuit [R. 122] was rendered and filed on the 17th day of January, 1941, and is reported in 116 Fed. (2d) 969. The decree of the United States Circuit Court of Appeals was filed and entered on the 17th day of January, 1941. [R. 130.] Petition of The Armature Exchange (appellee below) for rehearing was denied, on the 18th day of February, 1941. [R. 130.]

## Statement of Facts.

The essential facts of the case are fully set forth in the accompanying petition for writ of certiorari and in the interest of brevity are not repeated here.

## Specifications of Error.

1. The Circuit Court of Appeals erred in deciding that the operations of petitioner in rewinding burned out or damaged armatures constituted manufacturing or production of automobile parts or accessories within the purview of section 606 (c) of the Internal Revenue Act of 1932. [R. 122.]

2. The Circuit Court of Appeals erred in holding that Congress must be taken to have approved the administrative construction of Article 4, Regulations 46, approved June 18, 1932, and section 606 (c) of the Internal Revenue Act of 1932, by reason of the reenactment, without material change, of the statute taxing the manufacturing and production of automobile parts and accessories. [R. 128.]

3. The Circuit Court of Appeals erred in holding that the burned out armatures were discarded armatures and had lost their commercial value. [R. 127 and 129.]

4. The Circuit Court of Appeals erred in reversing the judgment of the District Court. [R. 129.]

## ARGUMENT.

### POINT I.

### The Circuit Court of Appeals Erred in Deciding That the Operations of Petitioner in Rewinding Burned Out or Damaged Armatures Constituted Manufacturing or Production of Automobile Parts or Accessories Within the Purview of Section 606(c) of the Internal Revenue Act of 1932.

(a) MANUFACTURING OR PRODUCTION CONSISTS OF THE APPLICATION OF LABOR OR SKILL BY HAND OR MACHINERY SO THAT AS A RESULT THEREOF A NEW, DIFFERENT AND USEFUL ARTICLE OF COMMERCE IS PRODUCED.

In this case petitioner seeks a refund of manufacturer's excise taxes paid by it upon the sale of used, secondhand armatures which petitioner had repaired by rewinding. All of said armatures were secondhand armatures when acquired by petitioner. That is to say, all of the armatures which petitioner rewound had been manufactured by some one at some prior time and had actually been used as operating parts of automobile motors. By reason of such use, the wire coils on the armatures had become damaged or burned out.

The method of repairing is set forth in the record. [R. Vol. II, Joint Exhibit No. 1.] From the series of 21 pictures and the explanatory statement of each contained in said exhibit, it can readily be seen that there was no loss of identity or dismantling of the component parts of the armatures. In fact, uncontradicted testimony of the

plaintiff's witness, Alfred Prescott Daniels, was as follows [R. 75-76]:

> "The only part that was removed was the winding or the wire from the armature."
>
> * * * * * * * *
>
> "No, there was no identification removed."

Therefore, if the petitioner's rewinding process commenced with an armature and ended with an armature, it is obvious that nothing has been manufactured or produced. No new article of commerce has been produced by the process; no new thing has been brought into existence. When the rewinder commenced his work he had an armature. [R. Vol. II, Joint Exhibit No. 1, p. 1.] When his work was completed he still had an armature. [R. Vol. II, Joint Exhibit No. 1, p. 21.] It makes no difference how long it took him to do the work, or how many different pieces of machinery he employed during the process, or whether he worked alone in a small shop, or whether he worked with many other workmen in a large plant, or whether, after the process was completed, he immediately reinstalled the armature in the automobile from which it was taken, or whether he laid it upon a shelf and subsequently exchanged it for another used, secondhand armature. The question is, what did the rewinder do? Did he produce or manufacture a new article? Did he merely repair an article which someone had previously produced or manufactured? Manifestly, he has repaired an armature. His work commenced after the manufacture or production of that armature had long since been completed and the armature had actually seen service as an operating part of an automobile engine.

The principle which lies at the bottom of the foregoing proposition was recognized and stated by the Court in

*Thurman, Collector v. Swisshelm, et al.* (C. C. A. 7), 36 Fed. (2d) 350. In that case the taxpayer dealt in automobiles. They bought completed Ford automobiles from the Ford Company or its agents. They bought from the Ames Company automobile bodies so constructed that they would fit the Ford chassis. They would remove the Ford bodies from the automobiles and replace them with the Ames bodies. The question was whether the taxpayers by that process became the manufacturers or producers of automobiles so as to become liable for the manufacturer's excise tax on the automobiles. The court held that the mere exchange of one body for another upon a completed automobile, originally manufactured by some one other than the taxpayer, did not constitute manufacturing or production. And in holding, the court distinguished the case of *Klepper v. Carter* (C. C. A. 9), 286 Fed. 379, in which the tax had been sustained as to a taxpayer who bought a truck chassis from one company and a body from another company, and then assembled the parts "for the first time into a complete truck," and said l. c. 351:

> "The facts are different in that there no truck figures in the transaction until the parts had been assembled and connected; while here appellees bought the completed automobile, upon which the tax had already been paid."

The principle underlying the *Swisshelm* case is in nowise different than in the case at bar. Swisshelm commenced his process with an automobile, completely manufactured and tax paid by the manufacturer; the petitioner in this case commenced its work with an armature previously manufactured and tax paid by a manufacturer. When Swisshelm finished his process, he still had an automo-

bile—he had created nothing new; when petitioner in this case completed its rewinding process, it still had an armature—it had created nothing new.

The Treasury Department recognized the principle laid down by the *Swisshelm* case in sales tax rulings which were in effect during the taxable period herein involved, and in sales tax ruling 648, in part said:

> "The retreading of old tires by resurfacing or replacement of the actual tread down to the tread line, without altering the side walls or destroying the original identity of the tire, does not constitute the manufacture of a taxable article."

For the convenience of this court sales tax ruling 648 is set forth in full in the appendix to this brief. (Appendix page 57.)

Jobbers, garage men and even the owners of fleets of automotive equipment sometimes maintain their own rewinding service and rewind their own armatures and those of their customers. No reason is suggested, and it is submitted no reason exists, why rewinding an armature in such a case and under such circumstances is mere repair or reconditioning, whereas manufacture is said to occur when, as in petitioner's case, an armature is rewound in the same way, but is not immediately replaced in the motor from which it was removed, but is held on the shelf for a time and subsequently exchanged with a customer whose armature is burned out and who does not desire to wait while his own armature is rewound.

In *Anheuser-Busch Brewing Association v. United States*, 207 U. S. 556, the plaintiff sued to recover certain import duties which it had paid on corks designed for use in bottling beer. Under the act there involved petitioner

was required to prove as the basis of its refund or "drawback" that the corks involved were not manufactured corks, but merely materials imported to be used in the manufacture of corks in the United States. The evidence showed that the corks when imported into this country from Spain had already been cut by hand to the required size. It was further shown that in such condition, however, they were not suitable for use in bottling beer because they would not retain the gas in the bottle and because they would impart a cork taste to the beer, thereby making it unmarketable and unfit for use. After importation, however, the corks were subjected in the brewing company's plant to various processes and treatment consuming several days of time, during which the corks were treated, processed, sealed and coated so as to render them useful for the intended purpose. The court found that the process to which the corks were subject did not constitute manufacture; that the corks were manufactured before they were imported and that the brewing company was not entitled to its refund. In the opinion by Mr. Justice McKenna it is said, l. c. 559:

> "The corks in question were, after their importation, subject to a special treatment which, it is contended, caused them to be articles manufactured in the United States of 'imported materials' within the meaning of section 25. The Court of Claims decided against the contention and dismissed the petition. 41 Ct. Cl. 389.
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> "The treatment to which the corks were subjected is detailed in Finding 3, inserted in the margin.
>
> "In opposition to the judgment of the Court of Claims counsel have submitted many definitions of 'manufacture,' both as a noun and a verb, which,

however applicable to the cases in which they were used, would be, we think, extended too far if made to cover the treatment detailed in Finding 3 or to the corks after the treatment. The words of the statute are indeed so familiar in use and meaning that they are confused by attempts at definition. Their first sense as used is fabrication or composition,—a new article is produced of which the imported material constitutes an ingredient or part. When we go further than this in explanation, we are involved in refinements and in impractical niceties. Manufacture implies a change, but every change in an article is the result of treatment, labor, and manipulation. But something more is necessary, as set forth and illustrated in *Hartranft v. Wiegmann,* 121 U. S. 609, 7 Sup. Ct. Rep. 1240. *There must be transformation; a new and different article must emerge, 'having a distinctive name, character or use.'* This cannot be said of the corks in question. A cork put through the claimant's process is still a cork." (Italics supplied.)

In the case of *American Fruit Growers, Inc. v. Brogdex Company,* 283 U. S. 1, the court was obliged to determine whether the process of impregnating the rind of an orange with borax, thereby rendering it resistant to mold and decay, constituted manufacture. In the opinion of Mr. Justice Reynolds, it is said, l. c. 11:

"Answering affirmatively the Circuit Court of Appeals said: 'The product claims define an article of manufacture, since the fruit is the result of a process which is defined and described and not a natural product. The product is a combination of the natural fruit and a boric compound carried by the rind or skin in an amount sufficient to render the fruit resistant

to decay. The complete article is not found in nature and is thus an article of manufacture. *Riter-Conley Mfg. Co. v. Aiken,* 121 C. C. A. 655, 203 Fed. 699 (35 Fed. (2d) 107).

"This position, we think, is not tenable.

" 'Manufacture,' as well defined by the Century Dictionary, is 'the production of an article for use from raw or prepared materials by giving to these materials new forms, qualities, properties, or combinations, whether by hand labor or by machinery.' Also, 'anything made for use from raw or prepared materials.'

"Addition of borax to the rind of natural fruit does not produce from the raw material an article for use which possesses a new or distinctive form, quality, or property. The added substance only protects the natural article against deterioration by inhibiting development of extraneous spores upon the rind. There is no change in the name, appearance, or general character of the fruit. It remains a fresh orange fit only for the same beneficial uses as theretofore."

In *Hughes v. City of Lexington,* 277 S. W. 981, the appellant was a corporation engaged in the business of making and selling ice cream. Nevertheless the City of Lexington contended that the corporation was not engaged in manufacturing within the meaning of the state statutes which exempt from city taxes machinery, material and supplies used in manufacturing. In the opinion by Clark, C. J., it is said, l. c. 982:

"The sense in which the term is here used, as well as the purpose intended to be accomplished by the act, is quite plain. Obviously, the term 'engaged in manu-

facturing' was not employed in any technical sense, but must be accorded its ordinary meaning as commonly understood. And, while incapable of exact definition, nevertheless it is true, as was stated in several of the above cases, that according to common understanding and generally speaking, manufacturing consists in the application of labor or skill by hand or machinery to material so that as a result thereof, a *new, different* and useful article of commerce is produced." (Italics supplied.)

The foregoing cases emphasize and reiterate the principle that whether a given process constitutes manufacturing depends upon whether the process results in the creation of a new thing. If that which emerges at the conclusion of the process is the same thing which entered the process at its beginning, notwithstanding some labor and some new materials have been expended upon it during the process—in other words, if the thing retains its identity during the course of the process and after it is completed—then no manufacturing or production has occurred. If the article before the process commenced was a cork and it emerged from the process still a cork, there has been no manufacture. By the same token, the principle as applied to the case at bar leads inevitably to the conclusion that since the armatures in question did not lose their identity during the rewinding process, but were armatures when they entered petitioner's plant and were still armatures when they left the plant, there was no manufacture.

(b) THE MERE REPAIR, RESTORATION OR RECONDITIONING OF AN ARTICLE DOES NOT CONSTITUTE MANUFACTURING OR PRODUCTION.

An essential distinction must be preserved between manufacture which, as above shown, results in the creation of a new article. and mere repair which results only in the restoration of partial injury but does not create a new article. When an article which consists of several component parts sustains wear or suffers injury to one of those parts, the plain economics of the situation dictate that the injured part, if possible, shall be replaced or repaired, rather than that the entire article shall be wastefully discarded.

The distinction between repair or restoration, on the one hand, and manufacture or construction, on the other hand, is often called in question and decided in patent cases.

Perhaps the leading case in this field is *Wilson v. Simpson,* 9 How. 109. In that case the owner of a patented planing machine had repaired or reconditioned his machine by placing therein certain new parts, particularly the knives or cutting tools which were the important operative agency of the machine or, as it is sometimes said, the ultimate effective tool Notwithstanding the fact that the cutting tools were the most vital and important part of the machine and did the very work for which the machine was designed, the court had no difficulty in finding that their replacement constituted only repair of the machine and not manufacture or production of a new machine so as to infringe the patent. In the opinion by Mr. Justice Wayne, it is said, l. c. 123:

> "But it does not follow, when one of the elements of the combination has become so much worn as to

be inoperative, or has been broken, that the machine no longer exists, for restoration to its original use, by the owner who has bought its use. When the wearing or injury is partial, then repair is restoration, and not reconstruction.

"Illustrations of this will occur to anyone, from the frequent repairs of many machines for agricultural purposes. Also from the repair or replacement of broken or worn-out parts of larger and more complex combinations for manufacturers.

"In either case, repairing partial injuries, whether they occur from accident or from wear and tear, is only refitting machine for use. And it is no more than that, though it shall be a replacement of an essential part of a combination. It is the use of the whole of that which a purchaser buys, when the patentee sells to him a machine; and when he repairs the damages which may be done to it, it is no more than the exercise of that right of care which everyone may use to give duration to that which he owns, or has a right to use as a whole."

In *Hess-Bright Mfg. Co. v. Bearing Co.*, 271 Fed. 350, the court considered a case involving the alleged infringement of a patent upon a ball bearing. The bearing consisted of a groove of a certain depth with balls exactly fitting it. The vendee of this patented bearing reground or smoothed up the groove, an operation which necessarily resulted in somewhat enlarging the groove. This necessitated installing larger balls to fit the enlarged groove. The question was whether or not the owners of the bearing had constructed a new bearing so as to infringe the patent or whether he had merely repaired his bearing. The court found that there was no manufacture

involved in the process and that the patent had not been infringed. In the opinion of Dickinson, district judge, it is said, l. c. 351:

> "Counsel for plaintiff does not, of course, formulate the claim of right as defendant states it. He does not deny to the vendee of plaintiff the right to repair. What he does deny is any right, by using plaintiff's bearing as a model, to make a new bearing from the raw material of the old one. It is obvious that all this is nothing more than opposing statements of the effect of what the defendant had done. The defendant calls it the repair of old bearings. The plaintiff calls it new construction or reconstruction. Omitting the name properly to be applied to what was done, the fact finding is made that what was done was the regrinding of the groove of the old bearings, and, when required, the substitution of new balls to fit the grooves enlarged by the regrinding.
>
> "The dividing line between repairs and a making over cannot be verbally located. What has been done can with more or less confidence be pronounced to be one or the other, but neither the one nor the other can be defined. The judgment pronounced must in consequence partake of the *ipse dixit* or rescript character. A further consequence is that the adjudged cases provide us with little for our guidance. With no thought of finding a better mode of expression for the clearly presented views of counsel for plaintiff, it may be premised that a feature of the patented bearing is the metallic pathway provided in the form of a groove, which calls for the use of balls of a certain size. The nicety of adjustment required can be most emphatically expressed by the statement that the unit of measurement employed is the ten-thousandth

part of an inch. This groove may, from use or abuse, be in need of being remade by regrinding. The lightest repolishing, almost, is such.

"The argument that this is not repair, but a new construction, may be thus expressed: A bearing with a groove of a certain depth, with balls exactly fitting it, is sold by the plaintiff to A. Another bearing, with a different groove, calling for the next larger size balls, is sold to B. The first vendee smooths up the groove in his bearing, thus adopting it to the next larger size of balls. By so doing he has not repaired the bearing sold to him, but out of the material in this old bearing he has made a new one, which is not his old bearing, but a different bearing of the B type. In other words, the old A bearing has lost its identity by destruction, and a new bearing, B, has been made. In a sense this is, of course, true; but it is only true in a sense. Identity is not lost by a mere change in size. The rule of which we are in search is a practical rule for the guidance of practical men in practical business. What the patentee sells is a concrete thing. It is a bearing. As long as it remains the bearing of the patent, it is what the patentee sold. The moment it becomes something else, the patentee is not concerned with it. The groove of the patent is still the groove of the patent, although enlarged. It no more loses its identity by enlargement than a river does by the change of the volume, due to the flow and ebb of the tide, or by the shoaling or deepening of its channel by the wash of its current.

"The balls are no part of the groove, but something used with it. There is no thought of denying the right of a vendee to repair balls. His right is not limited to any size of ball. The balls may be

replaced without thought of infringement of any patent right. To deny vendee the right to smooth up a groove is to deny him all right to make repairs to the patented features of what was sold to him. The right cannot be limited to the use of the same balls as before. The only limitation is that he may repair, but cannot make a new bearing out of the material of the old. What is the one and what the other facts of each case must determine. The line, as before observed, is most difficult to draw in words of description; it is by no means so difficult to draw in fact.

"In the instant case our fact finding is that what defendant has done is to make repairs, and that it has not infringed upon the patent rights of plaintiff. The name given to anything is not necessarily indicative of what the thing is. A fact upon which defendant lays much stress has some interest as a coincidence, but no other value. The fact referred to is that the plaintiff itself did what the defendant has done, and the department in charge of such work was called by plaintiff its 'Repair Department.' We attach as little importance to the distinction between repairing and selling second-hand bearings after they have been repaired."

In *Foglesong Machine Co. v. Randall Co.* (C. C. A. 6), 239 Fed. 893, the defendant, being the owner of a patented machine for the stuffing of horse collars, was accused of infringing the patent by making certain repairs upon the machine. The court found that certain parts of

the machine were perishable in that they were subject to greater wear than other parts. In that connection the court said, l. c. 895:

> "The question for decision is: Did the defendant repair or reconstruct the machine which it purchased from the Grand Rapids Company? In supplying a new hopper, stuffing rod nose, and disc, the defendant merely returned to use the injured or lost portions of the mechanism. This constitutes repairing, and not reconstruction."

At another point the court said, l. c. 896:

> "The machine was not so broken and worn out as to require replacement. The wear and injury were but partial. Under such circumstances, repair is not reconstruction, but restoration, that the mechanism may be kept up to the full performance of its duty."

In *Goodyear Shoe Machine Co. v. Jackson* (C. C. A. 1), 112 Fed. 146, it is said in the opinion by Colt, C. J., l. c. 151:

> "Where the patent is for a machine, which commonly embraces the combination of many constituent elements, the question of infringement by the purchaser will turn upon whether the machine is only partially worn out or partially destroyed, or is entirely worn out, and so beyond repair in a practical sense. In the case of a patent for a planing machine composed of many parts it was held that the replacement of the rotary knives, 'the effective ultimate tool' of the machine, was repair, and not reconstruction, *Wilson v. Simpson,* 9 How. 109."

A further statement of the principals involved, together with a citation of many cases, is found in *Miller Hatcheries v. Incubator Co.* (C. C. A. 8), 41 Fed. (2d) 619.

In *State v. J. J. Newman Lumber Co.* (Miss.), 59 So. 923, the distinction between manufacture and repair is clearly stated by the Supreme Court of Mississippi as follows, l. c. 926:

> "A reasonable definition may be given to 'manufacturing' (Century Dictionary) as the system of industry which produces manufactured articles, and to 'manufacture' as the production of articles for use from raw or prepared materials, by giving to these materials new forms, qualities, and properties, or combinations, whether by hand labor or machinery, used more especially of production in a large way by machinery, or many hands working co-operatively. 'Repair' is to make whole or restore an article or thing to its completeness. In the general knowledge of the affairs of business and life, it will hardly be difficult to class those persons who are engaged in such employment."

Applying the principles announced and reiterated in the foregoing cases to the facts of the case at bar, it is clear that the injury to the used, secondhand armatures which the petitioner acquired and rewound was but partial. Only the wire coils were injured or destroyed. They were not "entirely worn out, and so beyond repair in a practical sense" (*Goodyear Shoe Machinery Co. v. Jackson,* 112 Fed. 146, 151), is conclusively proved by the fact that petitioner did restore them to their former condition of usefulness by the simple expedient of minor

repair. The basic thing or part is the core consisting of the shaft, commutator and laminated core, which was identified by Mr. Daniels, a witness for the petitioner. [R. 80.]

> "The Court: Often you would build it on—what do you call the basic thing, the coil?
>
> "The Witness: The armature is the basic thing, and we would put new wires on it, and turn it."

This is the principle which underlies the decision of the Supreme Court in *Cadwalader v. Jessup & Moore,* 149 U. S. 350. In that case the Supreme Court was called upon to decide whether certain imports of old India rubber shoes were dutiable as crude India rubber or as shoes composed of India rubber. The shoes were so worn as to be beyond repair and for that reason they had ceased to be shoes and were valuable only for the rubber which they contained. It is said in the opinion by Mr. Justice Blatchford at page 354:

> "The uncontradicted testimony is to the effect that the only commercial use or value of the old India rubber shoes, or scrap rubber, or rubber scrap in question, is by reason of the India rubber contained therein, as a substitute for crude rubber; that the old shoes were of commercial use and value only by reason of the India rubber they contained, as a substitute for crude rubber, *and not by reason of any preparation or manufacture which they had undergone;* that they could not fairly be called 'articles composed of India rubber,' and as such dutiable at 25 per centum *ad valorem;* and that, although the shoes may have been originally manufactured articles

composed of India rubber, they had lost their commercial value as such articles, and substantially were merely the material called 'crude rubber.' They were not India rubber fabrics, or India rubber shoes, because they had lost substantially their commercial value as such." (Italics supplied.)

The petitioner herein compares the above case to the case at bar, stating that the India rubber shoes had lost their commercial value as such articles, and substantially were the material called "crude rubber." It is agreed that they were correct in reference to the shoes, because they were not imported as used shoes to be repaired, but only for their value as crude rubber. In the instant case the armatures were repaired to restore them to their former condition of usefulness. If the petitioner had converted the armatures into some other automobile part then there might be some color of right in the respondent's contention; in fact, this action would never have been instituted.

The respondent based practically its entire case upon the decision in the case of *Clawson & Bals v. Harrison*, 108 Fed. (2d) 991. In order to get a clear picture of this case it is necessary to refer to the findings of fact and conclusion of law as found by the trial court. This case is not published in the National Reporter System, but may be found in Commerce Clearing House, 1939 Standard Federal Tax Service, Vol. 4, paragraph 9219. For the convenience of this court the findings of fact and conclusions of law made and entered by the court are submitted in the appendix to this brief (App. p. 28).

Clawson & Bals had new connecting rod forgings made for them, which they machined and babbitted. During

part of the period covered by their suit, they removed all marks of identification from rods manufactured by General Motors Corporation and subsidiaries. They also rebabbitted used and secondhand connecting rods. At paragraph 10 of the findings of fact the trial court found:

> "Plaintiff kept but one stock with respect to each number and had but one outright price with respect to the rods, irrespective of whether they were produced from entirely new castings or from scrap, and regarded the articles made from scrap as equivalent to any similar products made entirely from virgin metal. The rods made from scrap were in competition with similar products made entirely of virgin metal and were just as serviceable. They were held out for sale and sold on the same basis and under the same warranties as the connecting rods produced from entirely virgin forgings. In other words, plaintiff made no distinction between such connecting rods in the numbering, cataloging, selling, billing, advertising, shipping, labeling, pricing, marketing, quality, warranty, guaranty or otherwise."

As stated before, Clawson & Bals dealt in three kinds of connecting rods; newly-manufactured ones, rebabbitted rods on which the identification marks had been removed and other rebabbitted rods. They at all times held themselves out as manufacturers, as in truth they were. As manufacturers they paid excise tax on all sales of rods, but did not include as part of the sale price the exchange value of the old rods received as part of the selling price. Later the Government assessed a total of $54,232.02, representing tax and interest on the additional selling price as represented by the value of the old rods received in exchange. Immediately Clawson & Bals objected on the ground that they were only rebabbitters of a part of the

rods sold by them and that the additional tax paid by them of $54,232.02 should be refunded as representing the tax on the sale of rebabbitted connecting rods.

It is submitted that the facts in the *Clawson & Bals* case are entirely different from the facts in the case at bar. Clawson & Bals did manufacture new connecting rod forgings from virgin metal, they removed identification marks from a part of the rods rebabbitted by them, they were manufacturers and held themselves out as such, whereas the petitioner herein never manufactured an armature, or held itself out as a manufacturer, never removed any identification marks from the armatures and in fact never did more than repair used and damaged armatures.

A man may drop his watch and break the main spring so that its usefulness as a timepiece is, for the time being, destroyed. But in such a case the owner does not throw his watch away and buy another. Instead, he takes it to a skilled mechanic who replaces the broken or damaged part and restores the watch to its former condition of usefulness. No one would argue in such a case that the jeweler had manufactured a watch. The admitted fact is that the owner took a watch to him. True, the watch was damaged and would not operate, but it was, nevertheless, a watch. After the jeweler had repaired the main spring, it was still a watch. It never lost its identity as a watch. Such is the process of repair or restoration as distinguished from the process of manufacture. The fact the man receives back his own watch after repair or for the purpose of saving time exchanges it for a second-hand watch already repaired which the jeweler may have in his stock for sale, would in no wise make the jeweler a manufacturer or producer of watches.

## POINT II.

**The Circuit Court of Appeals Erred in Holding That Congress Must be Taken to Have Approved the Administrative Construction of Article 4. Regulations 46, Approved June 18, 1932, and Section 606(c) of the Internal Revenue Act of 1932, by Reason of the Reenactment of the Statute Taxing the Manufacturing and Production of Automobile Parts and Accessories Without Material Change.**

### (a) Treasury Regulations Do Not Acquire the Force and Effect of Law Until They Have Been Recognized and Settled by Court Decree.

Treasury regulations are adopted after the enactment of laws by Congress in order to clarify and to set up administrative procedure. At the time Congress passed the Internal Revenue Act of 1932 there was no regulation in effect which would apply to that act, and Congress cannot be taken to have delegated to the Treasury Department any legislative prerogatives as would be true if the decision of the Circuit Court of Appeals is correct.

Certainly Congress cannot be considered to have recognized the force and effect of the administrative construction of section 606 (c) adopted by the Treasury Department, until those regulations have been given judicial approval by this Honorable Court. It is well established law that the Treasury Department has no authority to amend a congressional act or extend the meaning thereof by regulation, see *Koshland v. Helvering,* 298 U. S. 441, at 447, wherein the court states:

> "But where, as in this case, the provisions of the act are unambiguous, and its directions specific, there is no power to amend it by regulation. Congress

> having clearly and specifically declared that in taxing income arising from capital gain the cost of the asset disposed of shall be the measure of the income, the Secretary of the Treasury is without power by regulatory amendment to add a provision that income derived from the capital asset shall be used to reduce cost."

The statute in the case at bar is unambiguous and the great weight of authority as evidenced by the decisions of Federal and State jurisdictions cited and discussed under Point I of this brief, shows that the operations of petitioner herein constituted repair only, and petitioner must therefore be excluded from the effect of said act.

To apply the contention of the Circuit Court of Appeals as laid down by the opinion in the instant case would presuppose a presumption by Congress that Treasury Regulations would be adopted which would extend this act. There is such a doubt created that it has become necessary for this Honorable Court to decide the question so that a multiplicity of suits may be prevented and a just application of the law assured.

The courts have frequently been called upon to interpret taxing statutes. In doing so it has become recognized law that any doubt shall be resolved in favor of the taxpayer.

(b) TAXING STATUTE MUST BE STRICTLY CONSTRUED AND SHOULD BE SO CONSTRUED AS TO PRODUCE UNIFORMITY AND EQUALITY IN THEIR APPLICATION. THEIR PROVISIONS CANNOT BE EXTENDED BY IMPLICATION.

There was no dispute at the trial of this case to the methods employed by the petitioner in rewinding armatures. In fact the method was covered by a series of 21 pictures and an explanatory statement for each, which were introduced as a joint exhibit. [R. Vol. II, Joint Exhibit No. 1.]

The government produced no direct evidence whatever that the rewinding of armatures is a manufacturing process or that the rewinding of armatures constitutes the manufacture of armatures.

Being totally without any direct evidence that rewinding is a manufacturing process, the government apparently attempted to prove its case by the use of a syllogism which runs something like this: All large establishments employing many men, using many machines and turning out a large volume of work, doing business on a large scale and publishing catalogues in which their product is described, are manufacturing establishments; plaintiff has all these characteristics; therefore, plaintiff is a manufacturing establishment. The major premise of this syllogism is, of course, untrue, and the conclusion is, therefore, completely false. Size and extent and volume of business do not constitute the test of manufacture. It is common knowledge that there are many machine shops much larger than petitioner's which manufacture nothing, but are engaged only in repair work.

Much emphasis was also placed on the fact that the appellee was incorporated "to carry on the business of

manufacturing and assembling armatures * * * and to market them." [R. 106.] This corporation was organized in 1922 [R. 57], ten years before the enactment of the Revenue Act of 1932. The articles of incorporation were so broad that petitioner could do practically anything that an individual could do. [R. 106-109.] The test is not what the articles of incorporation recite, but what was actually done during the period involved.

If the taxing statute here involved is to be applied and administered by testing whether a company is a manufacturer or a repairman by determining whether it does business on a large scale or on a small scale, and whether it employs many men or few men, and whether its articles of incorporation authorize it to manufacture or not, then the administration of the taxing statute will result in the greatest inequality and lack of uniformity. The rewinder who sells several thousand armatures a month will be taxed because he is large and the rewinder who sells only a few armatures a month will not be taxed because he is small. The rewinder empowered to manufacture armatures will be taxed because of those powers, even though he is not exercising them.

The petitioner herein distributed printed catalogues, wherein were listed the armatures sold, showing the original manufacturer's name and parts number, in addition to appellee's code number. [R. 67-73.]

The mere fact that ownership of the armatures was vested in the petitioner does not affect its status as a repairer. There is nothing to prevent appellee from acquiring title to used armatures and repairing them and offering them for sale. Certainly there is no conflict here between the repairman being also the owner and vendor or only the repairman of the used armatures for others.

The true test, and the only test, is whether the rewinding process itself results in the creation of a new article, or whether it only accomplishes the restoration of an article already created. That is the test which can be applied to every rewinder and will result in absolute equality and uniformity of administration of the taxing statute.

In *City of Louisville v. Zinmeister* (Ky.), 222 S. W. 958, l. c. 959, the Supreme Court of Kentucky said:

> "In the recent case of *Lorrilard Co. v. Ross, Sheriff*, 183 Ky. 217, 209 S. W. 39, we held that the word 'manufacture' in the sense in which it is employed in the statutes quoted above, does not import the means or methods employed, or the nature or number of processes resorted to, or the size of the factory or the number of hands it employs, or the volume of machinery in use, but the result accomplished, whether the article is manufactured or not."

It is elementary that taxing statutes are to be construed strictly in favor of the taxpayer. This means that the tax must be based upon express statutory authority and cannot be imposed by implication. In *Hartranft v. Wiegmann*, 121 U. S. 609, it is said in the opinion by Mr. Justice Blatchford, at page 616:

> "We are of the opinion that the decision of the Circuit Court was correct. But, if the question were one of doubt, the doubt would be resolved in favor of the importer, 'as duties are never imposed on a citizen upon vague or doubtful interpretations.' *Powers v. Barney*, 5 Blatchf. 202; *United States v. Isham*, 84 U. S. 17 Wall. 496, 504; *Gurr v. Scudds*, 11 Exch. 190, 191; *Adams v. Bancroft*, 3 Sumn. 385."

In *Miller v. Standard Nut Margarine Co.,* 284 U. S. 498, it is stated in the opinion by Mr. Justice Butler, at page 508:

> "It is elementary that tax laws are to be interpreted liberally in favor of taxpayers and that words defining things to be taxed may not be extended beyond their clear import, doubts must be resolved against the government and in favor of taxpayers. *United States v. Merriam,* 263 U. S. 179, 188, 29 A. L. R. 1547, 44 S. Ct. 69; *Bowers v. New York & A. Literage Co.,* 273 U. S. 346, 350, 47 S. Ct. 398."

In *Erskine v. United States* (C. C. A. 9), 84 Fed. (2d) 690, 691, it is said:

> "Such revenue acts must be construed strictly in favor of the appellant sought to be charged as importer. He is 'entitled to the benefit of even a doubt.' Tariff Act 1897, 30 Stat. 151; *United States v. Riggs,* 203 U. S. 136, 1939, 27 S. Ct. 39, 40, 51 L. Ed. 127; *Hartranft v. Wiegmann,* 121 U. S. 609, 616, 7 S. Ct. 1240, 30 L. Ed. 1012; *Miller v. Standard Nut Margarine Co.,* 284 U. S. 498, 508, 52 S. Ct. 260, 76 L. Ed. 422."

In *Bankers Trust Co. v. Bowers* (C. C. A. 2), 295 Fed. 89, 96, it is said that the construction placed on a statute should avoid unjust consequences unless the act compels such a result. This is particularly true of a taxing statute where absolute uniformity and equality are to be preserved.

In *Alaska Consolidated Canneries v. Territory of Alaska* (C. C. A. 9), 16 Fed. (2d) 256, l. c. 258, it is said in the opinion by Rudkin, C. J.,:

> "Of course there is a presumption that laws, and especially tax laws, will have a prospective operation

> only; but there is a like presumption that they are intended to operate uniformly and equally upon all and in the end, the question is one of legislative intent."

The contention of the government that some distinction may be made predicated upon the fact that the petitioner is a large operator would seem to be specifically refuted by the case of *Spreckels Sugar Refining Co. v. McClain* (C. C. A. 3), 113 Fed. 244, opinion by Circuit Judge Dallas. In that case the statute imposed an excise tax on all gross receipts in excess of the sum of $250,000.00 per annum. A monthly return was required by the law, which did not specifically require anything but an annual payment of tax. The Spreckels Company filed a return for the first month, showing receipts in excess of the sum of $250,000.00, and it was contended that the law should be construed that the construction of the act contended for by the government was "so questionable as to render it inadmissible to impose a duty upon a citizen," citing the *Hartranft* case, and further held that such an inequality in the administration of the law could not be imposed upon the plaintiff simply because the returns were so large that its first monthly return exceeded $250,000.00. The court said in the opinion, l. c. 247:

> "We have already pointed out that it is not necessary to put an interpretation upon this section which might involve such inequality in its administration and, except by necessity, no such interpretation could be justified."

The opinion of the learned trial court in this case [R. 11-25] discloses that in every respect the principles announced in the foregoing authorities were closely adhered

to. After carefully reviewing the evidence which had been adduced at the trial the court stated [R. 24]:

> "If a person with mechanical skill were asked to rewind an armature, by one who paid him the value of his labor and materials, would the process be one of manufacturing? I do not think so. The fact that this company does this on a large scale does not alter the situation. In neither case are we dealing with a 'manufacturer' or 'producer.'"

On the question of the wording of the articles of incorporation, on which the appellant lays great emphasis, the trial court said [R. 105]:

> "Under these articles, they can sell everything but liquor. They can do billposting, and everything else. I don't know what good this will do."

Thus it can be seen that the court weighed the very points which are here urged by the respondent and specifically decided that large size of the plant, number of employees and authorization of the articles of incorporation would not constitute the test of the application of the statute.

It is a cardinal principle of tax law that any doubt shall be resolved against the taxing authority. To do otherwise in this action would be to work great hardship upon the petitioner and controvert all established law on that point.

Had Congress intended the tax herein involved to attach to the sale of repaired automobile parts such provision would have been put in the Internal Revenue Act of 1932. Failure to put such provision in that act shows clearly that it intended for the tax to attach to the sale of only newly-manufactured parts.

## POINT III.

### The Circuit Court of Appeals Erred in Holding That the Burned Out Armatures Were Discarded Armatures and Had Lost Their Commercial Value.

These armatures were not "junk," and had not been discarded by their former owners as is contended by the respondent. On the contrary, they had been carefully preserved and had been sent to this petitioner either directly or through jobbers so that they might be rewound or exchanged for other armatures of a similar type which had already been rewound.

Harry E. Seneker, testifying for the petitioner, when asked what percentage of the armatures were procured from jobbers, stated [R. 97]:

"A. Approximately 95 per cent."

If these armatures were so far worn out and so beyond repair that they had ceased to have any value over and above the melting pot value of the metal contained in them, why did plaintiff pay an average of from fifty cents to one dollar for them? If the court can draw upon its fund of common knowledge and take judicial knowledge of the fact that there is such a thing in the steel industry as scrap, then it must also know that steel scrap is regularly bought and sold as a commodity of commerce at a price of a few dollars per ton. The current price for scrap steel is now $11.50 per ton, slightly more than half cent per pound, which makes the junk value of an armature core about 5 cents.

Under the undisputed evidence in this case, it is conclusively proved and established that these armatures had a commercial value to the petitioner and to other con-

cerns engaged in the rewinding business in excess of their "junk value." It is obvious that the comparatively great commercial value of used armatures in excess of the melting pot value of the metals contained therein is due entirely to the fact that these armatures may be restored to their former condition of usefulness and mechanical efficiency by a process of repair.

## Conclusion.

Petitioner respectfully submits the decision of the Circuit Court of Appeals for the Ninth Circuit holding petitioner liable for a tax on the sale of repaired burned out automobile generator armatures is an erroneous decision of an important question of Federal law which has not been but should be settled by this Honorable Court; that the decision of the Circuit Court of Appeals for the Ninth Circuit is of an important question of general law, untenable and in conflict with the weight of authority and it is respectfully urged that this petition be granted in order that this Honorable Court may pass upon the important question and reverse the decision of the Circuit Court of Appeals for the Ninth Circuit thereby relieving petitioner of a grievous injustice.

Dated: This 27th day of March, 1941.

Respectfully submitted,

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